STATEMENT OF MITCH BAINWOL
CHAIRMAN AND CEO
RECORDING INDUSTRY ASSOCIATION OF AMERICA

BEFORE THE
SUBCOMMITTEE ON TELECOMMUNICATIONS AND THE INTERNET
COMMITTEE ON ENERGY AND COMMERCE
UNITED STATES HOUSE OF REPRESENTATIVES
ON
"THE AUDIO AND VIDEO FLAGS: CAN CONTENT PROTECTION AND TECHNOLOGICAL INNOVATION COEXIST?"

June 27, 2006

Chairman Upton, Ranking Member Markey, and Members of the Subcommittee, thank you for allowing me to participate today in this discussion on audio flag. To answer the titular question posed in this hearing, yes, we believe that content protection and technological innovation can coexist. And we believe that implementation of an audio flag is a fair and effective way to balance content protection and the wide range of new digital features. But to understand why measures such as an audio flag are needed, it is necessary to consider how we arrived at this point.

As you are aware, the music industry has faced an immense challenge in online piracy over the past several years. In addition to sharply declining sales figures, composers, artists, musicians, technicians, and a multitude of others engaged in the music industry have seen their jobs disappear. There are fewer people, and much less money, to invest in new artists and new music. Fewer resources to invest in the future, with an impact ultimately felt by consumers.

In response, we have not sought to stifle new technology, we have embraced it. Today, consumers have more choices in how they obtain their music than ever before:

online downloads such as iTunes; subscription services such as Napster and Rhapsody, including portability features such as Napster to Go, and special discounted rates for subscription services at colleges; ringtones; ringbacks; mobile downloads; mobile videos; online videos on demand; kiosks in retail stores; legitimate peer-to-peer services; interactive web radio; and instant post-concert recorded CDs are just some of the new formats in which we are making music available. These are in addition to new physical formats such as DVD-Audio, Super Audio CD, and DualDiscs.

Not only does the content protection present on these systems coexist perfectly with the technology that makes them work, these new technologies and services are, in fact, dependent upon that content protection to succeed. Technological innovation requires financial risk, which relies upon an expected return. Satellite broadcast services, for example, protect their signal to prevent others from free riding off their investment. In addition, the content carried on those signals is just as – if not more – valuable. If satellite services knew that anyone would be able to offer the exact same content – including music, sports, and multi-million dollar radio personalities – at a fraction of the cost (or free), they would never have invested in it. This is true for any new platform or service.

As with satellite and other services, content protection has allowed us in the music industry to innovate in the digital world, which has presented us with an opportunity to once again grow after several years of decline. The legal online download market, in particular, has been growing at a spectacular rate. Authorized download services such as emusic, Napster, and iTunes have truly taken root and are, for the first time, promising to

offset the loss in CD sales. This year, we are on track to see close to $1 billion in legal online downloads – that is, unless we are derailed.

Unfortunately, just as we are emerging from under the cloud of online piracy, we are facing a new challenge on the digital front. HD Radio and satellite services have begun, or plan to begin, offering features and companion devices that enable listeners to transform the passive listening experience into a download one. These services allow broadcast programs to be automatically captured and then disaggregated, song-by-song, into a massive library of music, neatly filed in a portable device's digital jukebox and organized by artist, title, and genre. Simply, users can download music and create a digital music library on their portable devices, in much the same way that iTunes offers permanent downloads. Of course, the big difference is that in the case of iTunes, Apple compensates artists, creators and copyright owners through a distribution fee.

To be clear: we are in no way against these new devices themselves. They are undeniably cool and, like everyone else, we understand their appeal. We are truly excited about the new opportunities digital radio and these devices will provide to expose new artists and offer consumers new choices in the way they get our music. Rather, our concern is when these devices and their corresponding services change radio into a download store without paying the fair market price for licensing music that other services offering the same content must pay. We have no issue with the convergence of radio and downloads, as long as they are licensed for that purpose.

We believe listeners should continue to be able to engage in the kinds of activities they've come to expect from radio, including recording. In fact, we look forward to users' ability to enhance this customary recording, by enabling automatic recording by

time, program, or channel, digital read-outs, music purchase options, time-shifting capabilities, in addition to storage and great new sound. Given all of these new amenities, our requests are actually strikingly modest – that the line be drawn at automatic searching, copying, and disaggregation features that exceed the experience listeners, the FCC, and Congress expect from over-the-air terrestrial and satellite radio.

The market for digital music operates on the basis of a continuum of content ownership. Distributors pay rights holders based on how much control over the content they give away. At one end we have radio, where users typically have little or no control over the content – they listen to whatever comes on. For offering this service, satellite pays content owners an amount based upon a statutorily set fee; in the case of terrestrial radio, due to a statutory anomaly, the broadcaster actually pays nothing. As we move up the continuum, through customized radio, tethered downloads, and portable tethered downloads, distributors pay content owners an increasing amount to be able to give their consumers greater control. At the other end of the continuum, we have permanent downloads and other forms of complete ownership, which give consumers the greatest flexibility in use of their content. For this, distributors pay a market rate, deservedly higher than the free or statutory license amount at the other extreme.

What we are seeing with these certain satellite and HD Radio services is a gaming of the system as they leapfrog from the limited control offerings of radio to the greater control of content offered by download services, but without paying the equivalent license fee. This not only fails to properly compensate creators, it threatens the licensed services that are playing by the rules – the very services we and so many others in the music community are relying on to deliver us from years of loss due to online theft. (It is

interesting that, as noted above, satellite services guard their investment by protecting their signal but, in the case of XM Radio, fail to understand the need to protect the valuable content they carry. After all, without content protection, there will be less investment in music; and music is the primary reason why customers purchase XM subscriptions.)

XM claims that it is already paying content creators. That is true, but what they are paying for is the *performance* of music – the statutorily-based license fee at the lower end of the ownership continuum. That is very different from (and much less than) the free-market *distribution* license required for download services. One is not a substitute for the other. XM's claim is tantamount to saying that if someone buys a ticket to watch a movie in a theater, he's entitled to take a DVD of the movie home with him afterwards. These are two distinct purchases, worth distinctly different amounts, and this principle is no less true when found in the digital world.

The transformation from a passive to an interactive listening experience without obtaining the proper license to pay the creator is especially troubling because, again, record labels and artists receive *absolutely no payment* from the performance of their works on terrestrial over-the-air radio. This unfair situation means that revenue, if any, comes only from the ultimate sale of that music to listeners. We are told that terrestrial radio's exemption from paying artists and record labels for the performance of their work is appropriate because radio serves a promotional purpose. We fundamentally disagree with this argument (the U.S. is in fact one of only a few countries not to grant artists and labels a performance right) but, even if true, it means nothing if there are no resulting sales. If the broadcast and its accompanying recording and archiving features replicates

the sale it is intended to generate, no amount of "promotion" will benefit content creators. Simply, we rely on sales. Without them, we cannot realize the return necessary to invest in new works and new artists, and songwriters cannot earn a living to continue writing the songs we all want to hear.

Fortunately, there are solutions. These are best worked out in the marketplace, and we have seen progress in that respect on a couple fronts. For satellite, we have entered into an agreement with Sirius that will ensure that content creators are properly compensated for their work. For HD Radio, we have been engaged in extremely productive talks with the broadcast industry. These talks certainly are based on our long and positive relationship with broadcasters, but were facilitated by the request of Chairman Stevens and Senator Inouye in the Senate Committee on Commerce, Science and Transportation during a January hearing on Broadcast and Audio Flag. We have come a long way since then and remain optimistic that a market-based solution that will protect content and compensate creators can be found.

Nevertheless, we are mindful that a true marketplace solution is not necessarily available to us. Unlike our friends in the movie industry, given our lack of a performance right for over-the-air radio and the compulsory license granted to satellite services, we are unable to withhold our content to ensure its proper use and compensation. Therefore, while we are encouraged that the broadcasters will continue to negotiate in good faith, we appreciate the introduction of legislation such as H.R. 4861, The Audio Broadcast Flag Licensing Act. This bill, introduced by Representatives Ferguson, Towns, Bono, Gordon and Blackburn, addresses this marketplace failure by granting the FCC jurisdiction to promulgate rules regarding content protection for digital radio. H.R. 4861 requires

digital radio services that use the government spectrum and the government-granted compulsory license to implement certain content protection technology. The bill also prevents unfair competition between radio services and download services by appropriately providing for private market negotiations of an "audio broadcast flag" that will differentiate between radio broadcasts and download services, and require a market license only for download services.

The bill assures that no one device or technology manufacturer has an advantage over another and will maximize the range of broadcast receiving devices made available to the public. Further, it makes clear that the adoption and implementation of an audio broadcast flag will in no way delay the final operational rules for digital radio and assures that legacy devices are not affected. By using broadcast flag technology, devices already on the market prior to the enactment of legislation will not be made obsolete, but will remain fully functional.

H.R. 4861 strikes the right balance between creating new radio services that bring more choices to consumers, and protecting the property rights of creators. In the meantime, we look forward to continued discussions with broadcasters and remain optimistic that we can arrive at an acceptable solution for everyone.

As we celebrate the one-year anniversary of the U.S. Supreme Court's decision in *Grokster*, we are reminded that content protection and technological innovation can, in fact, coexist. But the success of technological innovation and content creation is each dependent upon mutual respect for the value of the other. Mr. Chairman, I am here today in the hope that we can all continue on in the spirit of that *Grokster* decision – to recognize the value of creation and the importance of protecting it. Once again, our

message is simple: radio services should not be allowed to act like a download service without paying the appropriate license for distributions. An audio flag, and legislation such as the Audio Broadcast Flag Licensing Act which implements it, is an effective way to attain the proper balance of interests. We look forward to working with you and all of our partners in the broadcast and electronics industries to ensure a healthy and strong digital radio future.

Thank you.